GrummanWorld

Special Edition | **Our Employees Are Our Major Shareholders** | **April 21, 1989**

O'Brien To Shareholders: We'll Reinvent Grumman

Last year at this meeting I said that 1988 would be a much improved year for Grumman sales and earnings. It certainly was!

Sales were up eight percent to $3.6 billion, and earnings were up from 67 cents a share to $2.50. But our earnings should have been even better.

This afternoon, rather than dwelling on the improvements I'd like to begin my report to you by summarizing how we're continuing to attack our costs, enhance our competitive position and bring our performance into line with our potential.

Even though our revenues continue to grow in 1989, as previously announced we will eliminate 3,100 jobs this year. Over three years we will have reduced our employment on Long Island, where our operating costs are inherently higher than at other Grumman locations, by more than 6,000 jobs. I wish I could promise you that this painful process is completely behind us. But I cannot. However, I can say that we are improving our competitive position by increasing our productivity. Over that three-year period, the ratio of revenues per employee will increase over 20 percent.

At the same time, we have simplified our management structure by consolidating three divisions into one while also making substantial reductions of corporate staff and support services.

Today we are planning further consolidations. Three of our operating divisions — Electronics Systems, Melbourne Systems and Space Systems — apply many of the same technologies. All three are integrating complex electronics and software systems. Taken together, these divisions represent a systems expertise that is second to none in the world. And so we need to offer that total capability to our customers. For that reason,

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and also to better coordinate operations and share resources, we are organizing these divisions into a unified Systems Group.

We are also putting some of our physical assets to work much harder for the company. Grumman is the only member of the aerospace industry that still operates its own airport. And we operate two — one here in Bethpage and another at Calverton.

Our studies have established that the property covered by our runway in Bethpage is far too valuable to be used for occasional flight operations. Today, we think the best use is probably for high quality commercial office buildings that will be suitable as Long Island or East Coast headquarters for major corporations. That kind of development will enhance the community and release the value of the land to produce revenues — revenues we can share with partners that will contribute the capital and the real estate development know-how.

We also have property adjacent to our Holtsville computer center that we are planning to develop with established firms in the real estate development business. These are all drastic changes in the traditional Grumman. And some of you have asked me why I, of all people, should be making them...After all, I am a product of a 35-year career at the traditional Grumman. My answer is simple: I see the fundamental nature of our business changing rapidly. I am convinced that we must change rapidly to adapt to the new realities. And, as a Grumman traditionalist, I am convinced that the ability to change rapidly is basic to the Grumman tradition.

We were out of the fighter aircraft business until we seized the opportunity that became F-14.

We were out of the Apollo program until we regrouped and won the LM away from the leading competitor.

We came from behind in the competitions for the Space Station Program Support Contract and for the postal delivery truck.

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We had to survive three elimination rounds of competition with established military satellite builders to get to the finals in the BSTS competition.

And we did all that. The fact is that we have routinely reinvented this company, time and time again.

Well, it's reinvention time once more. Today, the United States and the Soviet Union are reinventing their relationship with each other. The Cold War is ending because the Soviets can no longer afford it. Secretary Gorbachev has proposed mutual force reductions in Europe and for his side, has put on the table 500,000 troops, 5,000 tanks, 8,500 artillery pieces and 800 combat aircraft.

This historic offer comes at a time when our government is obsessed with balance of trade and budget deficit problems at the end of the biggest military buildup in peacetime history. Military budget cuts were inevitable. But now those cuts will be made in the context of military force reduction agreements. Of course, reducing military forces is long overdue in a world that has been spending $100 million an hour for weapons, 24 hours a day, year in and year out — while people still go to bed hungry every night.

The world can well do with fewer weapons. But reducing force levels will not automatically make the world safer, just as glasnost and perestroika do not make the Soviets trustworthy. Just this month, they surprised us by selling to Libya Sukolov bombers that can deliver 24,000 pounds of weapons to targets 800 miles away. We're in for a delicate time ahead; it will be complicated by rapidly increasing economic competition with our traditional trading partners.

Now that the Japanese own most of our consumer electronics market and a major share of our automotive market, they are moving to challenge us in computer technology and to develop their own aircraft technology. The Europeans, who have been fighting each other since the invention of the spear, have now joined into an integrated market that creates a formidable new player in the world competition.

Now, what does this all mean to us at Grumman?

When the pressure is on to cut the budget, new development programs get stretched or canceled. Today, I think the most vulnerable ones are those that are especially provocative to the Soviets.

Programs such as stealth aircraft. I think the tactical stealth aircraft as well as the B-2 are at risk as the disarmament process goes forward. And, from what we read, both of the tactical stealth aircraft in development are also over-schedule and overweight, which makes them even more vulnerable.

Grumman, on the other hand, has proven aircraft in production that can be upgraded with relatively small investments to do the jobs that will be required in the next decade. However, the fiscal year 1990 Department of Defense budget, which has not yet been submitted, is reported to eliminate funding for some of our aircraft.

Frankly, it's impossible for me to make a sensible assessment this afternoon of the 1990 outlook. We're dealing with newspaper reports of what is supposed to be a secret process.

As reported, the preliminary DoD budget puts our F-14, A-6, and EA-6B programs all at risk. If this budget should be finally approved, submitted to the Congress and enacted into law, our business would be fundamentally changed — especially here on Long Island. Simply stated, we would have to further restructure Grumman into a different kind of a company.

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However, as reported the Navy has submitted rebuttal arguments against terminating its primary air defense aircraft, its primary strike aircraft and its only electronics countermeasures aircraft. A credible surface navy depends on these aircraft. There are no substitutes for them today and there can be no replacements for them for many years.

The preliminary DoD budget — as reported — would not only create fundamental changes in Grumman but it would — much more importantly — create fundamental changes in our national defense capability. It's interesting that the systems used in the past three years to protect our national interests, the A-6 and EA-6B in Libya and F-14 in the Mediterranean, are all reported to be out of the fiscal year 1990 budget while large quantities of "less expensive" systems are being planned. Systems, by the way, no carrier air group commander will commit to combat air patrol in the Mediterranean.

Could it happen? Yes. Almost anything could happen in Washington these days. Is it likely to happen? I honestly don't believe so.

I honestly believe that the preliminary budget is largely a budgeteer's product and that the requirements of the operating Navy will be considered before it goes to Capitol Hill. I know that on Capitol Hill the budget will be analyzed and debated in great detail before anything is enacted.

We'll take every opportunity the law allows to make sure our point of view is understood, both on the product and the political issues.

I'm optimistic. I believe there is some logic in this process, and logic dictates that we'll be in the

EA-6B and A-6 business for many years. The A-6 is the only aircraft that can strike a target at a distance that doesn't put the carrier at risk. And so without the A-6 the entire carrier task force doesn't make much sense.

I also expect that we'll sell the F-14D and ultimately the Tomcat-21 as the alternative to the Naval ATF. The Tomcat-21 concept is a winner because of its performance, because of budget pressures and also because the difference between the Navy and the Air Force missions has frustrated every effort in the past to develop a Navy fighter from an Air Force design.

So, at a time when budget pressures are going to be fierce, Grumman is in a position to offer upgraded versions of proven aircraft, rather than costly and high-risk development programs.

'The LM is a symbol of our future as well as our past.'

That's an opportunity position. To make it a winning position we have to be able to deliver quality products at the lowest possible cost...and that's why we're driving so relentlessly for improved productivity.

At the same time, we're aggressively pursuing new business. Today our backlog stands at more than $7.5 billion, which is more than twice our annual sales and one of the strongest backlog-to-sales ratios in our industry.

Last November, we dedicated a sensor test and integration lab for BSTS. If we win the final competition that will be decided next year, and we do intend to win it, BSTS will mean $10 billion or more to Grumman and will put us into a new business as a military satellite builder.

This month we dedicated a $50 million flight simulation laboratory that will help us win the Tomcat-21 and the advanced tactical surveillance aircraft as well as other aircraft and spacecraft programs in the future.

Last year we negotiated a teaming arrangement with Agusta, a leading Italian aircraft company, to compete for the next U.S. Air Force training system. And we began modernizing the F-8 Peace Pearl aircraft for the People's Republic of China.

Last year, when the total DoD budget was cut $30 billion, the funding for our Joint STARS program was increased almost $1.5 billion and its scope was expanded from 10 to 22 aircraft.

Last month we completed developing the Integrated Family of Test Equipment system that the Army will use to test all of its new electronic equipment, and we're now in the production phase of this $1.5 billion program, having been awarded an initial production contract.

Our program support contract with NASA, which essentially puts us in the role of integrating the work of the entire aerospace industry for the space station Freedom, is now into the preliminary design phase. We're also competing for additional space assignments...having won a new role for Grumman in space. The 20th anniversary of the day man walked on the moon this year will have a special meaning for all of us.

There are moments in history that are frozen for each one of us. Some of them are good. Lots of them are awful. But landing on the moon was a moment of undiluted joy and pride — especially here at Grumman, where Grumman people made the Lunar Module.

Twenty years ago, although I wasn't working directly on the LM program, I remember how proud I was to have colleagues who were — to be a part of the company that was responsible for landing men on the moon. Everybody here felt the same way.

The LM was, quite simply, a perfect flying machine. Absolutely perfect!

What made it perfect was a dedication to quality that was fanatical. George Skurla, who was director of Space Operations at Kennedy Space Center for LM, told me that he used to preach one thing: quality and safety are next to godliness. George sent everyone for eye exams to make sure they didn't miss anything.

Grumman people were so obsessive about quality, about doing a perfect job, that they wouldn't go home.

Joe Gavin was vice president for LM. He can tell you about random failures. At the beginning of the program, it was accepted that electronic equipment was statistically likely to fail; that somewhere, for no apparent reason, something would go wrong. Well, Grumman didn't accept the random failure theory. Grumman insisted that every failure had a cause — and, if you were careful, you could find the cause and fix it.

You probably remember exactly where you were when we landed on the moon and when we left the moon to come home. I was in the Plant 5 cafeteria, watching the return ascent on TV. I remember thinking that if anything goes wrong, we'll have left these men on the moon. We bet this company's reputation on getting them back.

The LM program gave Grumman a lot of its leaders. Joe Gavin, George Skurla, Tom Kelly, George Titterton, Bill Bischoff to name a few; the list is too long to go through here. In another way, the LM's perfection gave us Fred Haise, too.

Today, Fred is president of our Space Station Program Support Division — but on a later flight — Apollo 13 — he was a young astronaut who almost didn't come back from space. When a problem developed in the command module, the LM served as a lifeboat and got the astronauts home. It performed 'way beyond what was expected, doing a job it was never made to do. That's how much quality was built into it.

To commemorate that July 20, 1969, and Grumman's place in history, a new piece of art, created by our own Bob Whitehead, will hang in our headquarters lobby. I'll show it to you in just a minute, but first I have to tell you that we did a lot of thinking and debating about this. After all — the LM program was 20 years ago. Would putting a 28-foot-tall painting of it in our lobby suggest that we were living in the past?

The more we thought about it, the clearer it became that the LM is a symbol of our future as well as our past. The absolute dedication to quality that made the LM function flawlessly is the same dedication to quality that we must have in the difficult years ahead.

We've trained over 1,000 Grumman people so far in process GQ, which stands for Grumman Quality. Eventually, every Grumman man and woman will be trained.

GQ teams are helping us to write better proposals. They're trimming waste from our inventory procedures, they're improving the way we design, buy and build things. They're eliminating millions of pages of unnecessary paperwork and weeks of unnecessary procedures.

GQ means doing it right the first time, every time, just as the LM had to work every time.

How many of you here worked on the LM program 20 years ago? Had anything to do with it at all? I'd like you all to stand up and take a bow. George? Joe? Tom? We've got lots of them here — let's give them all a big round of applause...

Now, fellow shareholders, I'd be glad to answer any questions you might have.

Shareholders Want To Know

Shareholders asked John O'Brien the following questions at the annual meeting:

I would like to hear more about the future. Would you say something about fusion?

John O'Brien: BSTS is a $10 billion program at minimum and fusion is at least 20 years away. Our engineering concentration is on the near-term program. I still think they'll buy F-14s and that the Tomcat-21 will be an absolute winner. The Joint STARS is coming along very fast, and that's another $10 billion program if we successfully bring it into production.

What is Grumman doing in Washington about the possible elimination of three of our aircraft programs?

O'Brien: Remember, we are reacting to rumors coming from secret meetings, so they are very delicate issues and we have to handle them very delicately. But I assure you that we're doing everything possible to head off these problems. We have already briefed our congressional delegation and our senators. They have corresponded in writing and had meetings with key people. We have meetings scheduled with the Secretary of Defense in which all the arguments will be presented.

I see in the annual report that spending on research and development over the last three years has declined. Could you explain how you expect Grumman to be a major-league player in the future?

O'Brien: Capital and research and development spending tend to ebb and flow with the cycles of the business. We are very careful in selecting the fields we pursue. We are coming off a spending program of many hundreds of millions of dollars, to get into and stay in the competition for BSTS, to win the Joint STARS, to lose the ATA, unfortunately. It is my judgment that in this low period we're in that we can afford to focus on selected R&D areas and competitions, and that is exactly what we're doing. It is a dollar game, but no way can all of us chase all the butterflies that are out there.

Despite the fact that the company is nearing $1 billion in long-term debt, the fact that we're laying off employees, and employee morale is tremendously low, management continues to reward itself with a management incentive plan — to the tune of nearly $4 million in 1988. Could you please justify this for the employees.

O'Brien: You should examine the salaries of the management of this corporation, in comparison to the industry. Just take me as an example. Although we are about the 11th largest aerospace/defense firm in the country, I am probably the 50th-highest-paid chief executive officer — including management bonus, stock options and salary. If the board of directors did not award me or my associates an incentive bonus, in order to keep me or to attract other talent, they would have to pay me on some kind of par with the industry — just as Grumman must pay its engineers, production force, and inspectors on a par with the industry.

The New York congressional delegation has been very lax in responding to our predicament. Why does Grumman remain in such a hostile climate?

O'Brien: Our congressional delegation and senators are extremely supportive of this corporation and have been for many, many years. They're also in an area where there are many issues other than the defense budget, and are elected by a constituency that has other interests. Our problem is that we do not keep elected people in office long enough to gain seniority positions on the committees that affect what goes on in this part of the country. Given that, I think they are doing an outstanding job in protecting our interests. Don't confuse my criticism of the Long Island economic conditions and the Shoreham power plant actions with criticism of our congressional delegation. I think some of the other activities on Long Island deserve to be criticized and I've publicly stated it.